Technical Note — August 2009

Personal Accounts

Background

The Department for Work and Pensions (DWP) has estimated that seven million people in the UK are not saving enough for their retirement. With population projections suggesting that the 'over 65' population is set to double by 2055, the Government has responded by introducing a package of pension reforms to encourage personal saving for retirement and thus reduce the reliance on State pensions.

The reforms, which are due to take effect from 2012, will mean that all employers must offer a qualifying workplace pension scheme to their employees and that all eligible employees must be automatically enrolled into this chosen scheme.

Qualifying schemes

The personal accounts scheme is being set up to provide access to those people who currently do not have access to a workplace pension. Employees between 22 years of age and State Pension Age (SPA) and with earnings in excess of £5,035 (2005-06 level) must be automatically enrolled into either the personal accounts scheme or an alternative qualifying scheme i.e. an existing pension scheme which qualifies as exempt from the personal accounts requirements.

The personal accounts scheme will be run as a trust-based occupational scheme. Employers will have to contribute a minimum of 3% of qualifying earnings, with employees contributing 4% and a further 1% contribution in the form of tax relief. Qualifying earnings are defined as an employee's total earnings, including overtime and bonuses, between £5,035 and £33,540 per annum (2005-06 figures). In contrast, most existing occupational pension schemes base contributions on basic or gross earnings. For an existing workplace scheme to be classed as a qualifying scheme the contributions payable for each member must be regularly checked against the personal accounts levels.

Under the current proposals, employers will have 14 days from an employee's first day to complete the enrolment process. Employees will be permitted to opt out if they wish, however, if they do so they must be automatically re-enrolled every three years.

The Personal Accounts Delivery Authority (PADA)

The personal accounts regime is being implemented by PADA, a public body specifically established under the Pensions Act 2007 to help implement the workplace pension reforms. PADA is working in conjunction with the DWP and the Pensions Regulator, but is the body primarily responsible for the design and infrastructure for the new personal accounts scheme. The personal accounts scheme will then be managed on an ongoing basis by a not-for-profit trustee corporation.

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Consultation process

While the Pensions Act 2008 provided a basic framework for the new employer duties which are expected to come into force in 2012, much of the detail has still to be finalised.

PADA began the consultation process in 2008 by looking at the proposed charging structure for personal accounts and this was followed by a consultation document on the process for choosing and arranging retirement income. In May 2009 PADA issued a discussion paper on the proposed investment strategy for the personal accounts scheme. The document covers issues such as the default fund option, the investment approach as members near retirement and the number and types of funds that should be made available.

The first DWP consultation document was issued in March 2009 and considered the practical issues surrounding the operation of auto-enrolment, including information to be provided to employees and arrangements for opting-out. This was followed in April by a second consultation document, issued jointly by PADA and the DWP, on the proposed scheme order and draft rules. Further DWP consultation on the detailed employer duties is expected in Autumn 2009.

Other issues

For many employers, the financial impact of compulsory contributions, coupled with the anticipated increase in take-up rates as a result of auto-enrolment, will result in a significant increase to pension costs. To smooth the introduction of the new regime, contributions from both employers and employees will be phased in over a transitional period. Minimum employer contributions are likely to initially be 1% of qualifying earnings, rising to 2% before reaching 3%. The length of the transitional period will be specified by legislation.

Concerns have been raised that some people, especially lower earners, may not benefit from their retirement savings because of the interaction with means-tested benefits. Means-tested benefits such as Pension Credit are targeted at the least well off through an assessment of income and savings. Inevitably this means that the more income and savings people have, the less help they receive from the benefit system. Those who can only make limited savings may find that they are little or no better off from paying into personal accounts or other private pension arrangements because of the impact this will have on means-tested benefits at retirement.

Next steps

PADA launched a ‘myth busting’ programme in August 2009 to explain how the personal accounts scheme will work from 2012. The initiative will consist of an ongoing programme of meetings with key audiences including pension advisers, trade bodies and employers to explain the likely features of the scheme, clarify misunderstandings about its role and explore how personal accounts might be used.

The information in this note should not be relied upon or taken as an authoritative statement of the law.